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Financial Markets

Irving Trust

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Economic Research & Planning Division

Friday
(Noon)

Mar. 13, 1981

Financial markets rallied in the latter part of the week as the perception spread that the Federal Reserve clearly had eased its policy stance a notch. Most likely the immediate stimulus to the change was the $1.3 billion decline in M-1B announced last Friday. That snapped a succession of weekly increases and put the aggregate about $3 billion below the bottom of its "adjusted" 6%-8 1/2% target range. Apparently the Fed concluded that the sluggish pattern of M-1B growth in recent months was unlikely to improve without an easing of reserve availability.

That a policy change actually had occurred only became clear when the rate on Federal funds began to soften on Tuesday afternoon and continued soft on Wednesday morning--without the Fed entering the market to drain reserves. The Fed promptly provided further confirmation early that afternoon by entering the market to buy Treasury bills and later on by announcing that it would execute six-day customer repurchase agreements on Thursday (a very unusual transaction). All in all, the Fed left no stone unturned in indicating to the market that reserve needs in the statement week starting Thursday would be met from the very outset. If past relationships hold, then the funds rate should work down to the 13%-14% area before long. However, the Fed definitely will not tolerate a pell-mell drop of the funds rate, so that if the market should get carried away (as occurred three weeks ago) and put the funds rate down sharply to 13% or lower, the Fed will probably resist.

The market initially did not respond to the overt Fed actions on Wednesday, reflecting, in part, a prudent attitude toward Wednesday funds trading. But in addition, some "Fed-watchers" were anticipating that the Fed would purchase Treasury coupon securities instead of bills. Consequently, when bills were purchased, at least some participants were disappointed!

No doubt they are happier now, given the sharply lower funds rate. Nevertheless, it is useful to reflect why a Fed coupon purchase was never very likely this week and should occur even less frequently in the future than in the past. The bill market is much more liquid than the coupon market, and thus is the preferred arena for the Fed's large outright purchases and sales. In addition, the Treasury in recent years has systematically striven to increase the average maturity of its debt. Since in practice the Fed almost never sells coupons, coupon purchases run counter to the Treasury's efforts to lengthen maturities. (Recall that almost all Fed earnings are turned over to the Treasury.) Moreover, the Monetary Control Act of 1980 provides for a significant scaling back of member-bank required reserves, so that in the next several years the Fed should be a net seller of securities from its portfolio. In that setting the Fed is likely to be especially cautious about adding substantial amounts of coupon securities to its portfolio. In fact, just about the only reason for expecting the Fed to purchase coupons this week was the relatively large amounts still in dealer hands—but that consideration (alas!) carries little weight with the Fed.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	3/13/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	18.00%	18.50%	18.50%
Effective since	3/10/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	14.25	16.00	17.00
Repurchase Agreements	14.00	15.75	13.00
U.S. Treasury Issues			
Bills			
3 months	13.88	15.02	16.04
6 months	13.60	14.99	16.75
1 year	13.48	14.41	15.85
Coupons			
2 years	13.45	13.92	14.70
4 years	13.30	13.75	13.38
7 years	12.94	13.34	12.70
10 years	12.87	13.23	12.42
Long Bond	12.44	12.76	12.20
Negotiable Certificates of Deposit-Secondary Market			
1 month	14.15	15.50	18.00
3 months	14.25	15.70	18.25
6 months	14.35	15.75	18.50
1 year	14.50	15.50	17.50
Banker's Acceptances			
1 month	14.15	15.45	17.80
3 months	14.10	15.65	18.10
6 months	14.33	15.60	18.50
Eurodollar Deposits			
1 month	15.19	16.38	18.50
2 months	15.19	16.50	19.13
3 months	15.19	16.63	19.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	10.00	15.25	15.00
1 month	14.00	15.00	16.50
3 months	13.75	14.25	15.00
Bank Holding Companies			
1 month	14.38	15.63	16.75
Dealer Placed:			
3 months	14.25	15.25	17.00
New AA Corporate Utility Bond	14.90	15.75	14.50
Tax Exempt			
6 month Project Notes	7.05	7.20	7.25
1 year AAA Bond	7.10	7.30	NA
5 year AAA Bond	7.80	8.00	NA
20 year AAA Bond	9.65	9.85	9.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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